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February 22, 2011

Via Electronic Mail and Express Mail

Ms. Kristi Izzo
Secretary of the Board
Board of Public Utilities
Two Gateway Center, Suite 801
Newark, NJ 07102

Re: I/M/O the Long-Term Capacity Agreement Pilot Program ("LCAPP")
BPU Docket No. EO11010026

Dear Secretary Izzo:

Pursuant to the New Jersey Board of Public Utilities ("Board") Order dated February 10, 2011 ("Board Order") in the above captioned matter, enclosed please find the initial comments of LS Power Group ("LS Power") regarding the proposed form of the Standard Offer Capacity Agreement ("SOCA") to be used in the LCAPP. LS Power submitted a draft SOCA on February 14, 2011, utilizing the widely-used International Swaps and Derivatives Association, Inc. ("ISDA") master agreement and confirmation form. LS Power submits herein comments on the proposed form of SOCA and a red-lined version of the SOCA proposed jointly by the State's electric public utility / distribution companies ("EDCs"), to further assist the Board in its determination.

LS Power appreciates the opportunity to provide comments to assist the Board in its SOCA determination in the effort to improve the capacity marketplace for the benefit of New Jersey ratepayers. These initial comments will also be posted at www.nj-lcapp.com as directed in the Board Order. Please stamp and date the copy as "filed" and return it to our courier.

I. Introduction

New Jersey enacted legislation P.L. 2011, c.9 ("LCAPP Law") allowing up to 2,000 MW of new baseload or intermediate capacity to be constructed with support of a SOCA to be entered into between each EDC and eligible generators, as determined by the Board. The New Jersey Legislature required that the Board implement the LCAPP to promote efficient,

environmentally beneficial generation. The SOCA is a financially-settled contract for differences ("CFD"), whereby each EDC will pay the Seller a capacity charge, as defined in the SOCA, minus the applicable capacity Resource Clearing Price ("RCP"). In exchange, the Seller must offer the contract capacity into the PJM Base Residual Auction ("BRA") and participate in a cleared auction. The SOCA is not a power purchase or capacity agreement - the utility does not take title to the power or have bilateral contract rights with the Seller to the capacity.

The central theme of LS Power's comments herein is that the underlying purpose of the LCAPP, and therefore the interest of New Jersey ratepayers, is served by a simple and straightforward SOCA that is enforceable and financeable over its term in order to incentivize the development of the desired generation capacity.

II. The ISDA is an Appropriate Basis for the SOCA

The Board should adopt LS Power's proposed ISDA confirmation as the SOCA. The SOCA is a financially-settled, CFD, whereby the Seller is paid the difference between the Standard Offer Capacity Price ("SOCP") and the RCP. A CFD of this type essentially is a financial derivative, akin to a swap. The SOCA, by contrast, is not a power purchase or bilateral capacity contract. With these important characteristics and distinctions in mind, LS Power believes that the SOCA is best documented under the ISDA master agreement and confirmation. Indeed, the ISDA was specifically designed, and is widely used, for CFDs and swaps just like the financially-settled SOCA.

The ISDA, moreover, is widely accepted in the industry and likely has been utilized by the EDCs in other contexts. The ISDA is familiar to generation developers, the banks that provide financing to those developers, and other market participants in the energy industry. The ISDA has been "road tested" for many years in terms of enforceability and financeability – two key aspects necessary to support the legislature's goal when establishing the LCAPP. The ISDA also is supported by several legal opinions regarding a variety of circumstances confirming its enforceability with respect to netting and other matters. *See, for example*, http://isda.org/. Use of the ISDA form reduces uncertainty and risk for developers, banks, the EDCs and the Board, helping to ensure that the desired generation capacity is realized while protecting ratepayers.

While the ISDA master is an industry standard, it also offers sufficient flexibility for the individual parties to craft specific terms to meet unique circumstances, including those of the SOCA. The ISDA form also eliminates the need for extensive and complicated negotiations regarding most contract terms, leaving time to focus on the confirmation to the ISDA and therefore the unique aspects of the SOCA. This serves an important goal of executing the SOCA in a simple and timely manner, which further serves the legislature's and Board's intent.

Other participants may argue that the ISDA is not flexible enough to accommodate lengthy, detailed, highly negotiated provisions regarding commercial operations or collateral support. These comments miss the point.

Extensive negotiations regarding commercial operations are not necessary because the Board will determine eligible generators, PJM Interconnection, L.L.C. ("PJM") will administer the BRA and capacity auction and eligibility regime under its market rules, and other agreements

will govern the eligible generator's commercial operations. This is not to say that the SOCA confirmation should not contain any provisions regarding commercial operations, but those provisions should not be extensively re-negotiated in the SOCA. Instead those provisions should be incorporated by reference to the Board's eligibility determination, administration of PJM market rules, and other critical agreements such as the eligible generator's interconnection agreement and construction contracts.

The Board, for example, will qualify eligible generators only upon a "showing of environmental, economic, and community benefits, and through demonstrations of reasonable certainty of completion of development, construction and permitting activities necessary to meet the desired in-service date."[1] In turn, PJM will determine what qualifies as a capacity resource and the EDCs' annual forecasted peak demand, conduct the annual BRA and incremental auctions under its RPM, and establish the RCP for the applicable locational deliverability area. The commercial operation date of the facility will be governed and enforced by the generator's interconnection agreement and its notification to PJM, pursuant to its market rules that the Facility is substantially completed pursuant to the terms of the generator's major construction contracts. Therefore, there will be significant oversight regarding the commercial operations date of eligible generators through Board approvals and PJM's capacity market rules. With this in mind, the ISDA master agreement and confirmation form is an appropriate document for the SOCA and will serve the interest of New Jersey ratepayers.

Furthermore, on February 18, 2011, the EDCs proposed a draft form of security for their version of the SOCA. According to the EDCs, the form of security agreement creates a security interest in the SOCA payments and the generator's capacity payment from PJM under certain circumstances. The proposed security agreement also allows the generator to provide a Letter of Credit instead of granting a security interest to the EDCs. As described below, the provision of a security interest or any collateral by the eligible generator to the EDCs is not addressed in the legislation, and is not necessary when considered in the context of the financial payments involved. Indeed, the Rate Counsel acknowledges that the issue of security/collateral is not addressed in the legislation. Moreover, such a regime is redundant of other financial security and collateral provided by the generators to entities other than the EDCs throughout the development, interconnection and capacity auction process, which would result in significant over-collateralization, unnecessary additional costs and added risk to the generator.

Importantly, imposition of a security or collateral requirement would call into question the ability of a generator to obtain financing for its project. For these reasons, and as described below, LS Power cannot support a SOCA with a collateral or security requirement imposed on the eligible generator. With this in mind, LS Power does not address credit and collateral support documents associated with the ISDA master agreement.

LS Power urges the Board to use a simple, industry standard ISDA confirm as the SOCA. The ISDA confirm contract is industry standard for both financially-settled contracts and physical transactions. The form is well known to developers, banks, commodity dealers and load

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[1] N.J.S.A. 48:3-98.3(c)(6).

serving entities such as the EDCs. After several iterations, the current ISDA is mature and fully-developed, supported by legal review confirming its enforceability.

III. Specific Comments on the SOCA

LS Power urges the Board to adopt its draft SOCA, as proposed. In Q&A # 16 (at http://www.nj-lcapp.com/qa.html), we understand that the Board is developing material revisions to the February 14th draft SOCA posted by the EDCs. Although the Board should adopt LS Power's draft SOCA, we follow the Board's lead and given obvious time constraints for the Board's consideration, LS Power: (1) provides a redline of the EDCs' proposed SOCA (see Attachment A); (2) comments below regarding certain material changes in that redline; and (3) remarks on how LS Power's draft SOCA already addresses the material issues raised, and thus warrants acceptance by the Board. Our comments follow the order of suggested provisions found the in the EDCs' draft SOCA, for ease of the Board's review.

Summary of Revisions to EDCs' Form of SOCA:

- Security Agreement: The Generator's payment obligations to the Utility, if any, under the form SOCA are in any event likely to be insubstantial. This being the case, the granting of a security interest (or posting of collateral by the Generator) to the Utility by the Generator in payments that the Generator receives from PJM for Generator's supply of unforced capacity in the RPM is not commensurate with the financial risk posed to the Utility. The remedies available to each party under the contract are sufficient to protect each other in the event a party does not make a required payment pursuant thereto. The elimination of the security agreement requires deletions throughout the EDC draft, as indicated in our redline of that document. The LS Power draft SOCA does not include such a security agreement or collateral for the reasons expressed herein.

- Definition of "Available Capacity Amount": The definition of Available Capacity Amount must not have a blanket requirement that a Generator must clear the annual BRA. First, such a requirement would force Generators to submit below market bids against their best interest. Second, such a requirement is not necessary to comply with PJM's capacity market rules. The Generator should be held to what is bid as to quantity prior to the BRA for that delivery year, and not to a bid that might be mitigated or adjusted by future PJM market rule changes and, in turn, not clear in the auction. LS Power addresses this in its draft SOCA and request that the Board review its language.

  The comparable term in LS Power's proposed SOCA is "*Notional Quantity Per Calculation Period*": The lesser of (i) [XX] MW and (ii) the amount in MW of the Facility's UCAP actually cleared in the PJM BRA in the relevant Calculation Period; provided, however, that in the event that, and for so long as, PJM or a governmental authority either directly or indirectly suspends, prevents or eliminates the ability of the Facility to clear the PJM BRA, including through any circumstance or rule that prevents the Facility from being bid into the PJM BRA, or requires a certain minimum price to be bid into the PJM BRA, or any

circumstance or rule exists with similar effect, then the Notional Quantity per Calculation Period shall be deemed to be the amount set forth in clause (i) of this definition.

Moreover, while we do not agree with all of its arguments, Hess makes a general point that, rather than tie compensation to "cleared" capacity, the SOCA should document a transaction wherein the eligible generator is paid the SOCP for its available megawatts/capacity, determined by PJM. We also add the definition of Unforced Capacity to the EDCs draft.

- Other Definitions: The phrase "pursuant to the Act" has been deleted because it is redundant and the Board is acting under its authority to approve certain agreements entered into by the EDCs. For these reasons, LS Power's draft SOCA does not use the Act as a predicate for material definitions, requirements or preambles.

- Section 2.3 Obligations of the Generator:

  - Sections 2.3.1 and 2.3.3(b) (and related Event of Default under Section 7.1.9). The obligation of the Generator should be to cause the Capacity Facility to qualify under the RPM Rules as a capacity resource in an amount no less than the Available Capacity Amount for the BRA associated with each Delivery Year, not the Awarded Capacity Amount. This revision gives recognition to the reality that the amount of capacity in the RPM will fluctuate from year to year above or below the Awarded Capacity Amount due to changing EFORd. Furthermore, tying this obligation to Available Capacity Amount is also beneficial to ratepayers as the risk of changes to EFORd are shouldered by the Generator. Furthermore, the Generator should not be obligated to clear each BRA as this is redundant and burdens the Generator with undue economic risk. The Generator also already has significant risk under the PJM market rules. Under PJM's rules, if the generator has a deficiency, the Generator is then required to purchase replacement capacity in the incremental auction and/or pay deficiency charges. In short, if the PJM rules are followed by the Generator, then there should be no event of default or termination – the Generator bears the risk of payment reductions, replacement capacity obligations and deficiency payments imposed by PJM under its rules.

  - Section 2.3.2 (and related Event of Default under Section 7.1.7). This section should be deleted. The Generator should not be obligated under the SOCA to cause the Capacity Facility to achieve commercial operation no later than the Awarded Commencement Date and a failure by the Generator to do so should not result in an Event of Default under the SOCA. Such provisions are beyond the intended scope of the SOCA, which, is meant to be a purely financial contract that provides hedging

benefits to both the Utility and Generator. The underlying purpose of LCAPP is to support the construction of new generating capacity and the SOCA is only one means to that end. The creation of additional risk for the Generator under the SOCA through the inclusion Section 2.3.2 and 7.1.7 may defeat its intended purpose by creating risk that potential lenders may find unacceptable, overcomplicates the form and diminishes the flexibility of the Board to implement the LCAPP in a manner best suited to achieve its purpose. *See also* comments in Section II, above. The draft SOCA submitted by LS Power represents a superior allocation of risk between the Generator and Utility because there is not a default linked to the commercial operations date.

- Section 2.3.3(c) (now, section 2.3.2(c), after the proposed deletion of section 2.3.2). We note that Section 2.3.3(c) can be greatly simplified and serve its purpose just as well if it is revised to grant the Utility access to "read only" eRPM. The draft SOCA submitted by LS Power allows for this possibility.

- Section 2.5 Suspension of Obligations: Our deletions reflect the possibility that the Board may suspend certain provisions related to payment and obligations of the Generator to participate and clear BRA, but still desire that the Generator be paid under the SOCA. The SOCA draft submitted by LS Power allows for this possibility. Allowing otherwise would be detrimental to the underlying public good the LCAPP is intended to achieve, limit the authority of the Board effect the intended purpose of LCAPP and pose an unacceptable financial risk to a Generator.

- Section 5.1.11: Add the provision that "it drafted this Agreement, including without limitation the agreements, terms, representations, warranties and covenants herein, jointly with the other party."

- Section 5.2 Generator's Representations and Warranties: Generally, the revisions to the representations and warranties made by the Generator under the SOCA reflect the reality that determinations that are the province of the Board need not and should not be the subject of additional representations/warranties made by the Generator. The Utility, like the Generator, must rely on the determinations of the Board in instances where the Board is charged with making a determination such as whether the Generator is an "eligible generator." The Rate Counsel agrees, for example, that the SOCA only is effective after the issuance of a Board order including a determination of the eligibility of the generator. The representations and warranties found in the draft SOCA submitted by LS Power do not require a party to represent and warrant to facts that are determined by, and are the province of, the Board.

- Section 5.2.3: Delete the provision that neither the Generator not it and its Affiliate will enter into more than 700 MW of financially-settled SOCAs. This is

an unreasonable constraint, in that the requirements of the law could change. It is not clear over the many year term of the SOCA, moreover, whether two SOCA winners might not become affiliated at some point in the future, thus violating the Generator's warranties.

- Section 6.2 Recordkeeping: One party or the other should be made responsible for record keeping under the Commodity Exchange Act and related regulations. This has been addressed in Section 4 of the draft SOCA submitted by LS Power.

- Section 7.1.7 Failure to Achieve Commercial Operation of the Capacity Facility: Deleted for the same reasons as expressed in Section II of these comment and our comment regarding Section 2.3.2, above. The draft SOCA submitted by LS Power does not contain an Event of Default linked to the commercial operation of the Capacity Facility.

- Section 7.1.8 Failure to Participate in a BRA: This Event of Default is not appropriate and should be deleted because it appears to result in a near automatic default. Moreover, what if the Board suspends the need to participate and clear a BRA, which it can do if it is the first BRA and immediately successive BRAs, thus causing an Event of Default? Failures to participate in a BRA brings about remedies under the PJM procedures and rules and, at the same time, as we proposed, the generator continues to bear the EFORd risk. In short, if the PJM rules are followed by the Generator, then there essentially should be no event of default or termination – the generator bears the risk of payment reductions, replacement capacity obligations and deficiency payments imposed by PJM under its rules.

- Section 7.1.9 Failure to Clear a Base Residual Auction: Delete the entire provision for the same reasons set out above regarding the definition of "Definition of "Available Capacity Amount".

- Section 8 Termination Events: Through a variety of proposed termination events, the EDCs' draft seeks to introduce risks not associated with the core purpose of the LACPP, and therefore threaten the underlying purpose of SOCA as well as the financability of the facilities.

  Sections 8.1.1 – 8.1.5: Specifically, the following proposed termination events add unnecessary and uncontrollable risk to the generation development process. If any one of these events occur, it would result in termination of the SOCA, possibly several years after commencement of the agreement. No lender would accept such potential and long-term, uncontrollable risk regarding a significant asset. In short, if the PJM rules are followed by the generator, then there should be no event of default or termination – the generator bears the risk of payment reductions, replacement capacity obligations and deficiency payments imposed by PJM under its rules.

- Section 8.1.1 Illegality. As is reflected in the form SOCA proposed by LS Power, prior to terminating the agreement due to a change in law the parties should make every attempt reform the agreement to comply with law while keeping intact the intent of the parties with respect to their rights and duties under the agreement. Section 8.1.1 in conjunction with newly inserted Section 13.3 (Severability) accomplishes this without eliminating a party's right to terminate due to a finding of illegality of the Applicable Law.

- Section 8.1.2 Invalidity of the Act. A termination event tied to a finding that the Act is invalid creates undue risk for the Generator and creates a disincentive for prospective generators to participate in LCAPP. The SOCA may continue irrespective of the fate of the Act.

- Section 8.1.3 Denial of Utility's Recovery. A denial of the Utility's recovery of any cost directly or indirectly arising from Utility's performance of the SOCA should not result in a termination event. Allowing the Utility to do so would constitute a misappropriation of risk between the Generator and Utility. As noted in the comments submitted by the Rate Counsel, the "underlying public purpose is to support the construction of new generating capacity to ensure reliability and to serve the wholesale market." However, prospective generators will not likely endeavor to produce new generating capacity if they know their partner in such endeavor can walk away if the disallowance of a fee owed to them, no matter how small, may result in the termination of the SOCA.

- Section 8.1.4 Elimination or Substantial Modification of RPM. As with Section 8.1.3, Section 8.1.4 represents a substantial misappropriation of risk between the parties that creates a material disincentive for participation by prospective generators in the LCAPP. A better solution than termination of the SOCA is available and embodied in the newly added Section 13.2 (Change in RPM). Rather than allowing for the termination of the SOCA, a balance of risk between the parties can be achieved in the event the RPM is eliminated or modified by substituting the actual price obtained by the Capacity Facility for the Resource Clearing Price. (*See* also comments regarding Section 13.2 Change in the RPM, below and in the redline). The language of the newly added Section 13.2 is also in the draft SOCA submitted by LS Power as Section 5.

- Execution or Clearing Requirement. The generators should not be the one to bear the risk that the Utilities will not qualify for the end-user exemption from clearing contained in the Dodd-Frank legislation and regulations (this requirement should be rejected generally).

- Section 9.1.2 and Section 9.3.2. Payments on Early Termination due to a Termination Event: Deletion of certain Termination Events, as discussed above.

- Section 9.3.2. Payments on Early Termination due to a Termination Event: If the SOCA is terminated due to a termination event not under the control of Generator, it would be inequitable and an undue risk for the Generator to be obligated to payback to the Utility amounts received under the SOCA. The Generator would be in the unenviable position of investing years worth of resources into the creation of new generating capacity and, upon the occurrence of a termination event, faced with the possibility through no fault of its own that in addition to losing a portion of its financing it is on the hook for year's worth of payments received under the SOCA. Each party must bear risk in the transaction, but the risks borne by the Generator should not be those logically associated with the determination made by the Utility to participate in LCAPP.

- Section 10.2 Generator's Assignment Without Consent: The generator should be allowed to assign its rights under the SOCA as part of a financing and the EDCs should reasonably cooperate with such financing. This is industry standard in most agreements with generation developers. This issue is addressed in Section 6.1 of the draft SOCA submitted by LS Power.

- New Sections 13.2 and 13.3: Without these critical provisions, there would be too much regulatory risk such that an eligible generator may not be able to achieve financing in the first instance. The absence of such provisions would threaten the purpose of the LCAPP to the detriment of New Jersey's ratepayers.

    - Section 13.2 Change in the RPM (new provision): If a material change occurs in the RPM that eliminates capacity obligations, then the parties should remain bound to make the anticipated payments utilizing a market-approach to replace the RCP. *See* Section 5 of the draft SOCA submitted by LS Power.

    - Section 13.3 Severability (new provision). The invalidity or unenforceability of any provision of this Agreement will not affect the other provisions hereof, and the parties will negotiate in good faith to maintain the balance of the agreement. *See* Section 5 of the draft SOCA submitted by LS Power.

- Section 13.4 Dodd-Frank Act. Each party agrees to cooperate and consent to any amendment to this Agreement reasonably necessary to comply with margin or other regulatory requirements. Similar to the new sections 13.2 and 13.3, without a forward thinking provision to address the several unknown requirements under the Dodd Frank Act an eligible generator may not be able to achieve financing in the first instance. The absence of such provisions would threaten the purpose of the LCAPP to the detriment of New Jersey's ratepayers. This issue is addressed in Section 4 of the draft SOCA submitted by LS Power.

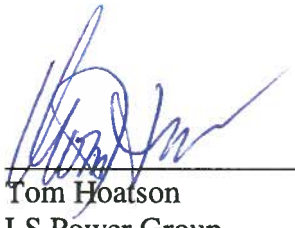
IV. Conclusion

LS Power respectfully submits that the Board should adopt its proposed ISDA confirmation for the pro forma SOCA. LS Power's draft SOCA is simple and utilizes a widely-accepted form, is enforceable and financeable and therefore supports the goals of the LCAPP and is in the interest of New Jersey ratepayers.

If the Board determines that the EDCs' draft SOCA or similar agreement warrants potential acceptance, then LS Power respectfully requests that the Board adopt its suggested revisions to the EDCs' draft SOCA as supporting the goals of the LCAPP and, therefore, in the interest of New Jersey ratepayers.

LS Power welcomes the opportunity to discuss these issues further with the Board, its Staff, and other participants in this process to improve the capacity marketplace for the benefit of New Jersey ratepayers.

Respectfully submitted,



Tom Hoatson
LS Power Group

Dated: February 22, 2011

ATTACHMENT A

**LS Power's February 22, 20011 redline
of the EDCs' February 14, 2011 SOCA Draft**